

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B02
PLR-128756-08
Date:
December 11, 2008

Legend

X:

Y:

A:

Trust 1:

Trust 2:

Date 1:

Date 2:

Date 3:

Date 4:

Dear :

This responds to a letter dated June 25, 2008, and additional correspondence submitted on behalf of X by X's authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated and elected to be an S corporation on Date 1. X's current owners are A, Trust 1 and Trust 2. On Date 2, X and Y executed a stock subscription agreement to Y in an event that may have terminated X's S corporation election. However, while Y transferred funds to X in order to acquire the stock, no stock certificate was issued to Y and Y's name was not entered on the books of X as a shareholder. In Date 3, X was informed by its tax advisers that Y would be an ineligible shareholder. On Date 4, the stock subscription agreement between X and Y was amended and made retroactively effective Date 2 and an X stock certificate was issued directly to Trust 1 and Trust 2, the effective owners of Y.

X represents that if there was a termination, the termination of X's election to be an S corporation were inadvertent and not motivated by tax avoidance or retroactive tax planning. X represents that since Date 2, X and each person who is or was a shareholder of X have filed federal income tax returns consistent with X's S corporation election. As soon as X discovered the potential terminating event, X initiated corrective action in order to maintain its small business corporation election. X and its shareholders have agreed to make such adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary.

Section 1362(a) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1361(c)(2) provides that certain trusts are permitted as shareholders. Section 1361(c)(2)(A) provides, in part, that § 1361(c)(2) shall not apply to any foreign trust.

Section 1362(d)(2)(A) provides that an election under § 1362(a) will be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) provides that the termination shall be effective on and after the date of cessation.

Section 1362(f) provides that if -- (1) an election under § 1362(a) by any corporation -- (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents, or (B) was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken -- (A) so that the corporation is a small business corporation, or (B) to acquire the required shareholder consents, and (4) the corporation, and each person who was a shareholder in the corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

Based solely on the representations made and the information submitted, we conclude that if X's S corporation election terminated on Date 2, under § 1362(d)(2), when X executed a stock subscription agreement with an ineligible shareholder, that this termination of X's S election was inadvertent within the meaning of § 1362(f). Accordingly, pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from Date 2 and thereafter, provided X's S corporation election was valid and was not otherwise terminated under § 1362(d). All of X's shareholders in determining their respective income tax liabilities during the termination period and thereafter, must include their pro rata share of the separately stated items of income (including tax-exempt income), loss, deduction, or credit and non-separately stated computed items of income or loss of X as provided in § 1366, make any adjustments to basis provided in § 1367, and take into account any distributions made by X as provided in § 1368.

Except as specifically ruled above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provision of the Code. Specifically, no opinion is expressed on whether X is otherwise eligible to be treated as an S corporation.

This ruling letter is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Pursuant to the power of attorney on file with this office, a copy of this letter is being sent to X's authorized representatives.

Sincerely,

Melissa Liquerman
Chief, Branch 2
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes

cc: